

Not to be released until 2:00 p.m.  
Japan Standard Time on Wednesday,  
August 16, 2006.

August 16, 2006

Bank of Japan

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# **Minutes of the Monetary Policy Meeting**

on July 13 and 14, 2006

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(English translation prepared by the Bank's staff based on the Japanese original)

A Monetary Policy Meeting of the Bank of Japan Policy Board was held in the Head Office of the Bank of Japan in Tokyo on Thursday, July 13, 2006, from 2:00 p.m. to 4:04 p.m., and on Friday, July 14, from 9:00 a.m. to 1:30 p.m.<sup>1</sup>

#### **Policy Board Members Present**

**Mr. T. Fukui, Chairman, Governor of the Bank of Japan**

**Mr. T. Muto, Deputy Governor of the Bank of Japan**

**Mr. K. Iwata, Deputy Governor of the Bank of Japan**

**Ms. M. Suda**

**Mr. H. Haru**

**Mr. T. Fukuma**

**Mr. A. Mizuno**

**Mr. K. G. Nishimura**

**Mr. T. Noda**

#### **Government Representatives Present**

Mr. K. Akaba, Senior Vice Minister of Finance, Ministry of Finance<sup>2</sup>

Mr. K. Sugimoto, Deputy Vice Minister for Policy Planning and Coordination, Ministry of Finance<sup>3</sup>

Mr. Y. Nakajo, Vice Minister for Policy Coordination, Cabinet Office

#### **Reporting Staff**

Mr. A. Yamamoto, Executive Director

Mr. N. Inaba, Executive Director

Mr. A. Horii, Executive Director (Assistant Governor)

Mr. M. Amamiya, Director-General, Monetary Affairs Department

Mr. S. Uchida, Senior Economist, Monetary Affairs Department

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<sup>1</sup> The minutes of this meeting were approved by the Policy Board at the Monetary Policy Meeting held on August 10 and 11, 2006 as "a document which contains an outline of the discussion at the meeting" stipulated in Article 20, Paragraph 1 of the Bank of Japan Law of 1997. Those present are referred to by their titles at the time of the meeting.

<sup>2</sup> Mr. K. Akaba was present on July 14.

<sup>3</sup> Mr. K. Sugimoto was present on July 13.

Mr. H. Nakaso, Director-General, Financial Markets Department

Mr. H. Hayakawa, Director-General, Research and Statistics Department

Mr. W. Takahashi, Deputy Director-General, International Department

Secretariat of the Monetary Policy Meeting

Mr. Y. Nakayama, Director-General, Secretariat of the Policy Board

Mr. T. Kozu, Adviser to the Governor, Secretariat of the Policy Board

Mr. K. Murakami, Director, Secretariat of the Policy Board

Mr. K. Kamiyama, Senior Economist, Monetary Affairs Department

Mr. N. Takeda, Senior Economist, Monetary Affairs Department

## **I. Summary of Staff Reports on Economic and Financial Developments<sup>4</sup>**

### **A. Money Market Operations in the Intermeeting Period**

The Bank conducted money market operations in accordance with the guideline decided at the previous meeting on June 14 and 15, 2006.<sup>5</sup> The uncollateralized overnight call rate was at effectively zero percent.

### **B. Recent Developments in Financial Markets**

In the money market, interest rates on term instruments rose. Interest rates on Euroyen futures increased, reflecting firm economic indicators.

Japanese stock prices started rising from the latter half of June. The Nikkei 225 Stock Average was recently moving at around 15,000 yen.

Long-term interest rates rose against the background of the rise in Japanese stock prices and firm economic indicators. Recently they were moving at around 1.9 percent.

The yen fluctuated somewhat against the U.S. dollar, partly reflecting market participants' speculation regarding U.S. monetary policy. The yen was being traded approximately in the range of 114-115 yen to the dollar recently.

### **C. Overseas Economic and Financial Developments**

The U.S. economy continued to expand at a pace around its potential growth rate, but the pace of growth in household spending and employment was moderating recently. As for prices, the pace of increase in the consumer price index (CPI) for all items was relatively fast due to high energy prices, and the core inflation rate (the CPI for all items less food and energy) increased moderately.

In the euro area, the momentum for economic recovery increased gradually as seen in the fact that exports, production, and business fixed investment were increasing and household spending had emerged from its weak situation against the background of the gradual improvement in the employment situation.

With regard to East Asian economies, in China both domestic and external demand

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<sup>4</sup> Reports were made based on information available at the time of the meeting.

<sup>5</sup> The guideline was as follows:

The Bank of Japan will encourage the uncollateralized overnight call rate to remain at effectively zero percent.

continued to expand strongly. The NIEs and ASEAN economies continued to expand at a moderate pace on the whole, although negative effects of high energy prices could be seen in some economic activity.

In U.S. and European financial markets, both long-term interest rates and stock prices rose. Prices of assets including stocks rose also in emerging economies, partially reversing earlier declines.

## **D. Economic and Financial Developments in Japan**

### **1. Economic developments**

Exports had continued to increase against the background of the expansion of overseas economies, and were expected to continue to rise as overseas economies expanded further, particularly those of the United States and East Asia.

As for domestic private demand, business fixed investment had continued to increase, and was expected to keep increasing since the growth in domestic and external demand and the high level of corporate profits were likely to be maintained. Firms' forecasts of current profits and their plans for fixed investment, both for fiscal 2006, in the June *Tankan* (Short-Term Economic Survey of Enterprises in Japan) supported the view that business fixed investment would continue growing over a wider range of industries and firm size with the continuing high level of corporate profits.

With regard to sales indicators related to private consumption, retail sales data had been sluggish due partly to adverse weather conditions, and some indicators for consumer sentiment were also somewhat weak. However, indicators related to services consumption were favorable on the whole.

Industrial production had continued to increase against the background of the growth in domestic and external demand. Production was expected to continue its uptrend, as overseas economies would continue to grow and the recovery in domestic demand would continue to be solid.

As for the employment and income situation, household income had continued rising moderately in a situation where various indicators were showing tighter labor market conditions. The gradual increase in household income was likely to continue against the background that firms were increasingly feeling a shortage of labor and the high level of corporate profits was being maintained.

The conditions of persistent excess supply had been dispersed, and the output gap seemed to have become positive. The weighted average of the *Tankan's* diffusion index for production capacity and the index for employment conditions suggested that the shortage in production factors was gradually increasing recently. The output gap was likely to continue to be positive.

On the price front, domestic corporate goods prices had continued to increase, mainly reflecting the rise in international commodity prices, and were expected to continue increasing. The year-on-year rate of change in the CPI (excluding fresh food, on a nationwide basis) had been on a positive trend, and this trend was projected to continue, as the output gap was likely to continue to be positive.

## 2. Financial environment

The environment for corporate finance was accommodative. The issuing environment for CP and corporate bonds was favorable, and the lending attitude of private banks had continued to be accommodative. Credit demand in the private sector had started increasing. Under these circumstances, the rate of increase in the amount outstanding of lending by private banks was accelerating, and the amount outstanding of CP and corporate bonds issued was around the previous year's level. Funding costs for firms had risen slightly. Meanwhile, the year-on-year growth rate of the money stock (M<sub>2</sub>+CDs) had been at the 1.0-2.0 percent level.

## II. Summary of Discussions by the Policy Board on Economic and Financial Developments

### A. Economic Developments

On the current state of Japan's economy, members concurred that, given economic indicators, including those in the June *Tankan*, that were released in the intermeeting period, the economy was expanding moderately, with domestic and external demand and also the corporate and household sectors well in balance, broadly in line with the Bank's projection presented in the April *Outlook for Economic Activity and Prices* (hereafter the Outlook Report), and they expected the economy to continue to expand moderately.

Members agreed that overseas economies taken as a whole continued to expand and were likely to keep expanding.

On the U.S. economy, many members said that it continued to expand. These members added that some indicators suggested a deceleration in housing investment and employment, and uncertainty about the future pace of economic expansion was increasing. Regarding price developments, many members said that the pace of the rise in the core CPI was gathering speed against the background of tight labor market conditions and the rise in prices of commodities including crude oil. These members commented that whether concerns about inflation would be contained in a situation where economic growth was decelerating was a focus of attention. One member pointed out that, although future developments in prices warranted attention, an increase in productivity had been reducing the rate of increase in unit labor costs and thus the pace of the rise in the core CPI had remained moderate to date.

With regard to East Asian economies, many members expressed the view that both domestic and external demand continued to expand strongly in China. On European economies, some members said that the momentum for a recovery had been increasing as seen in the fact that exports and production were growing and household spending was recovering. A few members said that economic fundamentals in emerging economies had been firm despite the decline in their stock prices. Based on the above discussion, members concurred that the global economy as a whole was continuing to expand, with growth gaining breadth geographically.

Regarding Japan's economy, members agreed that the increase in exports had continued, reflecting the expansion of overseas economies, and was likely to continue.

As for domestic private demand, members concurred that the strength in the corporate sector continued and this was benefiting the household sector.

With regard to developments in the corporate sector, members agreed that business fixed investment was likely to keep increasing, reflecting the growth in domestic and external demand and the continuing high level of corporate profits. Many members noted that corporate profits had been high on the whole according to the June *Tankan*, although high raw materials prices had adversely affected some materials-related industries. These members expected a continuation of growth in business fixed investment, given the clear upward revision of investment plans for fiscal 2006 in the June *Tankan* from the March survey and an increasing trend in leading indicators such as machinery orders. Meanwhile, one member commented that firms that had been focusing on restructuring and had thus

been restraining fixed investment might become less cautious about conducting investment as excess production capacity had dissipated and there was growing expectation of a rise in interest rates.

Members shared the view that private consumption, which had been on an increasing trend, was likely to continue to increase, mainly reflecting a gradual increase in household income. Some members said that, while indicators related to services consumption continued to increase, some sluggishness was being observed in indicators related to retail sales and consumer sentiment. These members continued that, although this was due partly to temporary factors such as adverse weather conditions, developments in consumer sentiment needed to be watched closely. One of these members added that the fall in stock prices also seemed to have affected recent developments in consumption. Meanwhile, one member pointed out that the economic recovery might be affecting different income groups differently, and if this was the case, the positive influence of favorable business performance on private consumption might be weaker than expected.

Members agreed that production had continued to increase and was likely to increase further against the background of the growth in domestic and external demand. Members also concurred that inventories had been more or less in balance with shipments in the industrial sector as a whole, and adjustments were progressing in inventories in materials industries, which had been relatively high. Some members said on electronic parts and devices that, although inventories did not seem especially large relative to shipments, attention should be paid to the risk of inventory adjustment, as the effects of temporary production adjustment mainly in East Asia were being seen. A few members said that, even if there were to be an inventory adjustment in this industry, it would only be small, partly because Japan's economy had learned from the experience of its temporary pause in 2004, which occurred together with an inventory adjustment. They continued, however, that attention should be paid to the risk of an inventory adjustment coinciding with an unexpected deceleration in the U.S. economy. One member said that, even though Japan's economy was likely to remain on an expanding trend, there might be small fluctuations in its growth that could lead to a temporary pause.

With regard to the employment and income situation, members agreed that household income had continued rising moderately in a situation where labor market conditions continued to tighten and the number of employees including full-time employees



continued to increase steadily. Some members noted that the growth of wages was moderate as firms were still restraining labor costs. One member expressed the view that firms were increasingly feeling a shortage of labor and this would eventually affect wages, but it would take some time.

As for the level of economic activity, members concurred that it was appropriate to change the assessment of the current state of Japan's economy from "Japan's economy continues to recover steadily" to "Japan's economy is expanding moderately," given that the estimated output gap seemed to have become positive, and the perception among firms of having a shortage of labor and production capacity was likely to grow further, judging from the June *Tankan*. Members also agreed that the change in the wording of the assessment of the current state of Japan's economy was a response to the change in the level of economic activity and was not an upward revision of the assessment of the current pace of economic growth.

With regard to prices, members agreed that domestic corporate goods prices continued to increase rapidly due mainly to the rise in international commodity prices such as those of crude oil and nonferrous metals, and were likely to continue to increase.

Members agreed that the year-on-year rate of change in the CPI (excluding fresh food, on a nationwide basis) was likely to continue to follow a positive trend, as the output gap continued to be positive. One member was of the view that there was no change in the uptrend in the CPI, because examination of the CPI excluding energy by goods and services showed that goods prices had been rising at a very moderate pace, and services prices continued to increase gradually reflecting the increase in labor costs and the fact that imputed rent of condominiums had stopped falling. Meanwhile, some members noted that recent surveys suggested that consumers' inflationary expectations might have recently undergone a relatively large upward revision.

## **B. Financial Developments**

On the financial front, members concurred that the financial environment in terms of corporate finance, such as the lending attitude of private banks and the issuing environment for CP and corporate bonds, remained extremely accommodative. One member said that, with this accommodative financial environment, the rate of increase in the amount outstanding of lending by private banks was recently accelerating and credit

demand in the private sector had started increasing.

Many members described the unstable movement of stock prices since the middle of May as an adjustment caused by investors' reassessment of their portfolio risks in a situation where monetary policy was becoming less accommodative worldwide. They also said that the rapidity of the adjustment was due mainly to an overreaching observed since the second half of 2005. Members agreed that, although stock prices worldwide seemed to have been regaining stability since the latter half of June, market developments at home and abroad required careful monitoring as the recently heightened geopolitical risks had brought new uncertainty.

### **C. Interim Assessment**

Given the above assessment of economic activity, prices, and financial developments in Japan, members agreed on the following interim assessment in relation to the outlook presented in the April Outlook Report. First, Japan's economy was expected to be broadly in line with the outlook. Second, domestic corporate goods prices in fiscal 2006 were expected to deviate above the outlook, reflecting the rise in international commodity prices, primarily crude oil prices. The rate of increase in fiscal 2007 was projected to be broadly in line with the outlook. And third, consumer prices were projected to be broadly in line with the outlook.

### **III. Summary of Discussions on Monetary Policy for the Immediate Future**

On the monetary policy stance for the immediate future, members agreed that, based on their assessment of the economic and financial situation, it was appropriate to raise the uncollateralized overnight call rate target from effectively zero percent to around 0.25 percent.

Members concurred that the stimulus from monetary policy had been gradually amplified as economic activity and prices improved steadily in line with the projection presented in the April Outlook Report, and thus maintaining the zero interest rate environment might result in large swings in economic activity and prices in the future. One member pointed out that the difference between the trend of the real GDP growth rate and the real call rate indicated that monetary policy had gradually become more stimulative recently. Another member said that, although there had not been overinvestment to date,

attention should be paid to the risk that it might occur in some sectors in the long term.

Given this situation, members agreed that it would be appropriate to adjust the level of the policy interest rate at this juncture so that a desirable course of economic activity and prices would be maintained, and this policy decision would contribute to price stability and sustainable growth in the long term. One member said that adjustment of the policy interest rate at this time should be considered not as a measure to cool an overheating economy but as one to underpin economic growth by reducing the volatility of economic activity and prices in the long term. A few other members pointed out that there was very little need for the Bank to maintain the unusual zero interest rate environment when the economic situation was returning to normal, and allowing natural formation of interest rates would support sustainable growth with price stability in the medium to long term. Some members added that, since market participants already expected that the Bank would bring the zero interest rate environment to an end in July, raising the overnight call rate target to 0.25 percent at this meeting was unlikely to disturb financial markets.

Members discussed what level the basic loan rate of the complementary lending facility should be. Many members expressed the opinion that it would be appropriate to raise the rate to 0.4 percent when the uncollateralized overnight call rate target was raised to 0.25 percent. Against this opinion, some members said that the appropriate level for the rate would be 0.5 percent.

The members who advocated raising the basic loan rate to 0.5 percent noted that the complementary lending facility had been heavily used recently because the current spread between the overnight call rate and the basic loan rate was too narrow. They were of the view that setting the latter at a relatively high level would encourage interest arbitrage and eventually contribute to restoring the proper functioning of the money market. One of these members added that the Bank should ensure stability of market sentiment not by limiting the extent of the raise of the basic loan rate but by communicating appropriately to market participants about the future conduct of monetary policy.

Meanwhile, many members were of the opinion that, while in the long run a wider spread was necessary to restore the proper functioning of the market, at this point the Bank should exercise the utmost care in controlling the call rate to keep it stable in the current situation where market functioning was still not fully restored despite its gradual recovery since the termination of the quantitative easing policy. Therefore, they supported the raise

of the basic loan rate to 0.4 percent.

Members agreed that, when referring to the rate applied to the complementary lending facility, the Bank should as far as possible use the official term "the basic loan rate" instead of "the official discount rate," which was not the official term but had been widely used, since the latter gave the impression that it was still the policy interest rate, even though it no longer played the role of indicating the basic stance of monetary policy.

Members agreed that the outright purchases of long-term interest-bearing Japanese government bonds should be continued at the current amounts and frequency for some time, with due regard for the future condition of the Bank's balance sheet.

Regarding the future path of monetary policy, members said that the Bank would conduct monetary policy by carefully assessing economic activity and prices. Members concurred that, if developments in economic activity and prices followed the Bank's projection presented in the Outlook Report, it was likely that the Bank would be able to conduct monetary policy in line with the thinking described in it. In other words, the Bank would adjust the level of the policy interest rate gradually in the light of developments in economic activity and prices, and in this process, an accommodative monetary environment ensuing from very low interest rates would probably be maintained for some time.

Members agreed that given that more market participants were coming to understand the Bank's basic thinking regarding the future course of monetary policy through its communication to date, the Bank should continue to take every opportunity to explain that there was no change to its thinking. In this connection, some members said that it was important that the Bank did not give the impression that it was rushing to raise the policy interest rate. One of these members said that the Bank should avoid giving the impression that it would carry out successive raises of the policy interest rate like the Federal Reserve. One member said that the Bank should explain more clearly at this point that it would adjust the level of the policy interest rate gradually. The member added, however, that the Bank should also explain that this approach was conditional on developments in economic activity and prices following the Bank's projection presented in the Outlook Report. A few members commented that the Bank's communication of its thinking regarding the future conduct of monetary policy should be based on that indicated in the Outlook Report so as not to restrict its future conduct of monetary policy unduly.

#### **IV. Submission of Policy Proposals**

Based on the above discussions, the chairman formulated the following three policy proposals to reflect the majority view: (1) the guideline for money market operations; (2) a change in the basic discount rate and the basic loan rate; and (3) release of a public statement concerning the change in the guideline for money market operations.

One member, however, said that the member would like to propose that the Bank should change the basic discount rate and the basic loan rate to 0.5 percent for the reasons the member had given earlier.

#### **The Chairman's Policy Proposal on the Guideline for Money Market Operations:**

1. The guideline for money market operations for the intermeeting period ahead will be as follows, effective immediately from the announcement of the decision.

The Bank of Japan will encourage the uncollateralized overnight call rate to remain at around 0.25 percent.

2. A public statement will be decided separately.

#### **The Chairman's Policy Proposal on a Change in the Basic Discount Rate and the Basic Loan Rate:**

1. The basic discount rate for discounting of bills pursuant to Article 33, Paragraph 1, Section 1 of the Bank of Japan Law and the basic loan rate for loans made pursuant to Article 33, Paragraph 1, Section 2 of the Law will be as follows, effective immediately from the announcement of the decision.

The basic discount rate and the basic loan rate will be changed to 0.4 percent.

2. A public statement will be decided separately.

### **The Chairman's Policy Proposal on Release of a Public Statement concerning a Change in the Guideline for Money Market Operations:**

The decision concerning a change in the guideline for money market operations will be made public by the attached statement (see Attachment).

Mr. A. Mizuno submitted a policy proposal to change the basic discount rate and the basic loan rate to 0.5 percent, effective immediately from the announcement of the decision.

### **V. Remarks by Government Representatives**

Following the chairman's proposal to change the guideline for money market operations, the representatives from the Ministry of Finance (MOF) and the Cabinet Office requested the chairman to adjourn the meeting because they needed to discuss the government's stance on the proposal and might need to contact the Minister of Finance and the Minister of State for Economic and Fiscal Policy. The chairman approved the request. (The meeting adjourned at 12:39 p.m. and reconvened at 1:00 p.m.)

After the meeting reconvened, the representative from the MOF made the following remarks.

- (1) Japan's economy was recovering. Although the economy had not overcome deflation, a comprehensive review of developments in prices suggested that the price situation was improving steadily, and the overcoming of deflation seemed to be gradually coming into prospect.
- (2) The chairman had submitted a proposal to bring to an end the zero interest rate environment. Since there was currently no concern about inflation, the government considered that it was important that the Bank continued to firmly support the economy from the financial side, and also considered that it did not necessarily need to rush in bringing the zero interest rate environment to an end.
- (3) However, if the Bank decided that it should come to an end, the government considered that, in terms of the real economy, it was important to firmly support economic activity thereafter by maintaining a sufficiently accommodative financial environment, in order to ensure the sustainability of the economic recovery. At the same time, it was also

important to secure market stability. Specifically, the government would like the Bank to clearly explain its thinking and the future course of monetary policy, given that financial markets could become unstable due to speculation. In particular, the government would like the Bank to communicate clearly to the markets that it did not intend to carry out successive raises of the policy interest rate. In addition, the government considered it necessary that the Bank closely monitor developments in overall interest rates including long-term interest rates, and that it continue its outright purchases of long-term Japanese government bonds at the current amounts.

- (4) The government would respect the Bank's decision on the timing of ending the zero interest rate environment based on careful examination of the economic situation at home and abroad as well as developments in financial markets, since the discussions and the policy proposals at this meeting showed that the Bank shared the government's views. The government would like the Bank to continue to support the economy from the financial side responsibly, thereby ensuring the sustainability of the economic recovery, secure the stability of financial markets, and implement appropriate monetary policy consistent with the government's economic policy.

The representative from the Cabinet Office made the following remarks.

- (1) The Cabinet had decided the text of "Basic Policies for Economic and Fiscal Management and Structural Reform 2006" on July 7, 2006. In accordance therewith, the government would pursue the enhancement of the economy's growth capacity and competitiveness, sound public finance, realization of a safe and reassured, flexible, and diverse society, and accelerate and deepen structural reforms.
- (2) Although Japan's economy was recovering, a close watch needed to be kept on price movements. In order to ensure the overcoming of deflation during the concentrated consolidation period and achieve sustainable economic growth led by private demand with price stability, the government would like the Bank to implement effective monetary policy that was consistent with the government's policy efforts and with its outlook for the economy while paying due consideration to developments in financial markets, and thereby support the economy from the financial side responsibly.
- (3) At this meeting the chairman had submitted a proposal to bring to an end the zero interest rate environment. The government would like the Bank to carefully examine

Japan's economy as well as the global economy, and developments, for example, in financial markets at home and abroad including those in stock markets, in deciding whether to bring the zero interest rate environment to an end. If the Bank decided to do so, the government would like the Bank to make it clear to the public that it would maintain an accommodative monetary environment ensuing from very low interest rates for some time. Moreover, to prevent financial markets from becoming unstable due to uncertainty about the Bank's future conduct of monetary policy, the government would like the Bank to clearly explain its outlook for economic activity and prices as well as the future course of monetary policy, so as to make it easier for market participants and the public to form an economic outlook.

## **VI. Votes**

The following three policy proposals submitted by the chairman and one submitted by Mr. A. Mizuno were put to the vote: (1) the guideline for money market operations, proposed by the chairman; (2) a change in the basic discount rate and the basic loan rate, proposed by Mr. A. Mizuno; (3) a change in the basic discount rate and the basic loan rate, proposed by the chairman; and (4) the release of a public statement concerning a change in the guideline for money market operations, proposed by the chairman.

The chairman's policy proposal on the guideline for money market operations was approved, by a unanimous vote.

Votes for the proposal: Mr. T. Fukui, Mr. T. Muto, Mr. K. Iwata, Ms. M. Suda, Mr. H. Haru, Mr. T. Fukuma, Mr. A. Mizuno, Mr. K. G. Nishimura, and Mr. T. Noda.

Votes against the proposal: None.

Mr. A. Mizuno's policy proposal on a change in the basic discount rate and the basic loan rate was defeated by a 6-3 majority vote.

Votes for the proposal: Ms. M. Suda, Mr. A. Mizuno, and Mr. T. Noda.

Votes against the proposal: Mr. T. Fukui, Mr. T. Muto, Mr. K. Iwata, Mr. H. Haru, Mr. T. Fukuma, and Mr. K. G. Nishimura.



The chairman's policy proposal on a change in the basic discount rate and the basic loan rate was approved by a 6-3 majority vote.

Votes for the proposal: Mr. T. Fukui, Mr. T. Muto, Mr. K. Iwata, Mr. H. Haru, Mr. T. Fukuma, and Mr. K. G. Nishimura.

Votes against the proposal: Ms. M. Suda, Mr. A. Mizuno, and Mr. T. Noda.

Ms. M. Suda dissented from the above proposal mainly for the following reasons. First, a relatively wide spread between the uncollateralized overnight call rate and the loan rate of the complementary lending facility should be set so that the facility would be used in line with the initial purpose, which was to prevent market rates from surging, for example, on the day of book closings or after some kind of shock, and thereby stabilize the rates. And second, a relatively wide spread would promote restoration of the proper functioning of the money market by encouraging interest arbitrage.

Mr. A. Mizuno dissented from the proposal, arguing that, unless a relatively wide spread was set, financial institutions would make heavy use of the complementary lending facility especially at times when many of them expected higher interest rates, and as a result it would become difficult for the Bank to control the pace at which financial institutions satisfied reserve requirements during a reserve maintenance period. He added that restoration of the proper functioning of the money market was likely to be delayed unless a relatively wide spread was set.

Mr. T. Noda dissented from the proposal for the following reasons. First, the fact that financial institutions were making heavy use of the complementary lending facility in a situation where the financial system had regained stability was undesirable from the viewpoint of market discipline, as it could hinder natural formation of market interest rates. And second, a relatively wide spread would encourage interest arbitrage and thereby contribute to restoring proper functioning of the money market.

The chairman's policy proposal on the release of a public statement concerning a change in the guideline for money market operations was approved, by a unanimous vote.

Votes for the proposal: Mr. T. Fukui, Mr. T. Muto, Mr. K. Iwata, Ms. M. Suda, Mr. H. Haru, Mr. T. Fukuma, Mr. A. Mizuno, Mr. K. G. Nishimura, and Mr. T. Noda.

Votes against the proposal: None.

Government representatives made the following points in comments after the votes. First, the government considered that the Bank shared its view that it was important to continue to firmly support the economy and to secure market stability, and hoped that the Bank would continue to implement appropriate monetary policy consistent with the government's economic policy. And second, the government considered it important that the Bank explain clearly the background regarding its decision at this meeting, and also explain that an accommodative monetary environment ensuing from very low interest rates would be maintained for some time. The representatives added that they planned to make public later in the day the government's response at this meeting to the Bank's decision.

## **VII. Discussion on the Bank's View of Recent Economic and Financial Developments**

Members discussed "The Bank's View" in the *Monthly Report of Recent Economic and Financial Developments* (consisting of "The Bank's View" and "The Background"), and put it to the vote.

The Policy Board decided, by a unanimous vote, the text of "The Bank's View." It was confirmed that "The Bank's View" would be published on July 14, 2006 and the whole report on July 18, 2006.<sup>6</sup>

## **VIII. Approval of the Minutes of the Monetary Policy Meeting**

The Policy Board approved unanimously the minutes of the Monetary Policy Meeting of June 14 and 15, 2006 for release on July 20, 2006.

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<sup>6</sup> The English version of the whole report was published on July 19, 2006.

Attachment

July 14, 2006

Bank of Japan

### **Change in the Guideline for Money Market Operations**

1. At the Monetary Policy Meeting held today, the Bank of Japan decided, by a unanimous vote, to change the guideline for money market operations for the intermeeting period, effective immediately from the announcement of the decision.

The Bank of Japan will encourage the uncollateralized overnight call rate to remain at around 0.25 percent.

2. With respect to the complementary lending facility, the Bank decided, by a 6-3 majority vote, to change the basic loan rate<sup>[Note]</sup> applicable under the facility to 0.4 percent, effective immediately from the announcement of the decision, and maintain the temporary waiver of add-on rates for frequent users of the facility. With respect to the outright purchases of long-term interest-bearing Japanese government bonds, purchases will continue at the current amounts and frequency for some time, with due regard for future conditions of the balance sheet of the Bank.
3. Japan's economy continues to expand moderately, with domestic and external demand and also the corporate and household sectors well in balance. The economy is likely to expand for a sustained period. Developments are broadly in line with the projection in the *Outlook for Economic Activity and Prices* (hereafter the Outlook Report) released on April 28, 2006. The year-on-year rate of change in consumer prices is projected to

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<sup>[Note]</sup> The basic loan rate is stipulated in Article 15, Paragraph 1, Clause 2 of the Bank of Japan Law. The basic discount rate in Clause 1 in the same paragraph is also set at 0.4 percent (Discounting bills has been suspended).

continue to follow a positive trend.

4. The Bank has maintained zero interest rates for an extended period, and the stimulus from monetary policy has been gradually amplified against the backdrop of steady improvements in economic activity and prices. In this environment, maintaining the previous level of the policy interest rate may result in large swings in economic activity and prices in the future. Taking account of the current assessment of economic activity and prices from the two perspectives outlined in the New Framework for the Conduct of Monetary Policy (March 2006), the Bank judged it appropriate to adjust the level of the policy interest rate at this juncture so that a desirable course of economic activity and prices was to be maintained. Today's policy decision will contribute to ensuring price stability and achieving sustainable growth in the medium to long term.
  
5. On the future path of monetary policy, the Bank will conduct monetary policy by carefully assessing economic activity and prices. The Bank will adjust the level of the policy interest rate gradually in the light of developments in economic activity and prices if they follow the projection presented in the Outlook Report. In this process, an accommodative monetary environment ensuing from very low interest rates will probably be maintained for some time.